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Possible future work on cross-border issues related to the judicial sale of ships: Proposal from the Governments of Malta and Switzerland

Note by the Secretariat

1. In preparation for the fifty-first session of the Commission, the Governments of Malta and Switzerland submitted to the Secretariat a proposal for possible future work by UNCITRAL on cross-border issues related to the judicial sale of ships. The text received by the Secretariat on 26 March 2018 is reproduced as an annex to this note.

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Annex

Proposal of the Governments of Malta and Switzerland for possible future work on cross-border issues related to the judicial sale of ships

1. Introduction

At its fiftieth session (Vienna, 3 to 21 July 2017), the United Nations Commission on International Trade Law noted the importance of a proposal (A/CN.9/923) of the Comité Maritime International (CMI) drawing attention to problems arising around the world from the failure to give recognition to judgments in other jurisdictions when ordering the sale of ships.[1] While a number of delegations supported the proposal and expressed interest in taking it up, subject to the availability of working group resources and any necessary consultation with other organizations, it was agreed that additional information in respect of the breadth of the problem would be useful.[2]

It was suggested "that CMI might seek to develop and advance the proposal by holding a Colloquium so as to provide additional information to the Commission and allow it to take an informed decision in due course".[3] The Commission further "agreed that UNCITRAL, through its secretariat, and States would support and participate in a Colloquium to be initiated by CMI to discuss and advance the proposal".[4] The Commission agreed to revisit the matter at a future session.[5]

To that end, following a request from the Government of Malta, the UNCITRAL secretariat extended a formal invitation to all Member and Observer States of UNCITRAL to participate in a high-level technical Colloquium in respect of the cross-border judicial sale of ships, as well as the recognition of such sales.

Based on the outcome of the discussions during the Colloquium and based on the support of all represented industries, the governments of Malta and Switzerland propose that UNCITRAL consider taking up work on an international instrument to resolve cross-border issues on the recognition of judicial sales of ships.

2. The Colloquium

The Government of Malta, through its Ministry for Transport, Infrastructure and Capital Projects, in collaboration with CMI and the Malta Maritime Law Association, co-hosted the Colloquium on 27 February 2018 at the Chamber of Commerce in Valletta, Malta. Panellists and attendees examined the scope of problems associated with judicial sales of ships, as well as possible solutions.

Participants were requested to elaborate on the proposal submitted by CMI to the Commission stating that "[p]urchasers, and subsequent purchasers, must be able to take clean title to the ship so sold and be able to de-flag the ship from its presale registry and re-flag the ship in the purchaser's selected registry so as to be able to trade the vessel appropriately without the threat of costly delays and expensive litigation. This, in turn, will enable the purchased ship to trade freely; and ensures that the ship will realize a greater sale price which will benefit all the related parties, including creditors (which could include port authorities and other government instrumentalities that have provided services to a ship owner)".[6]

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[1] *Official Records of the General Assembly, Seventy-second Session, Supplement No. 17* (A/72/17), paras. 456–465.

[2] Ibid., para. 464.

[3] Ibid.

[4] Ibid., para. 465.

[5] Ibid.

[6] See para. 5, A/CN.9/923.

3. Participation at the Colloquium

It was noted that the lack of certainty in recognition of judgment affected a broad spectrum of industries and States. The Colloquium had 174 participants, including delegates from 60 countries. Delegates represented Governments, including Governments of flag states; the judiciary; the legal community; a number of specific industries, such as shipowners, banks/financiers, shipbrokers, ship repairers, shipbuilders, bunker suppliers, port and harbour authorities, charterers, tug operators, and ship agents; and a number of International Organizations, such as the Institute of Chartered Shipbroker (ICS), BIMCO and the International Transport Workers Federation (ITF). The Colloquium also received a written submission by the Federation of National Associations of Ship Brokers and Agents. The participants shared how their industries and States were impacted by the lack of harmony among States in recognizing the judicial sale of a ship in another jurisdiction.

(a) Shipowners

A prominent shipowner representative identified four of the most important considerations in relation to judicial sales: (1) legal certainty; (2) maximization of the asset value; (3) availability of ship finance; and (4) ease of registration after the sale has taken place. It was stated that the failure to resolve these considerations distorted the ship sale market and caused asset value destruction to the detriment of the industry as a whole.

The presentations by shipowners, both as sellers and potential buyers, made clear that their primary interest was legal certainty, which was demonstrably absent from the current process of judicial sales. If greater certainty in the recognition process could be attained, it was thought to lead to a higher valuation in assets, in both auction and sale values, which would in turn result in greater availability of finance.

It was added that there was an interest of all involved in maritime trade (including cargo interests, trade-financing banks, insurers, and others) that the vessel employed not be stopped by unnecessary arrests instituted by former creditors or owners, despite the fact that the vessel had been sold by judicial sale. It was noted that any transit-interruption would be a nuisance to trade and shipping and would create costs and damages.

There was a clear statement by the shipowners that the situation needed to be clarified by way of an international instrument and that the points drafted by CMI could resolve the issue in a simple and pragmatic way.[7]

(b) Financiers/ship financing banks/shipbrokers

The support of many banks, regardless of their location, for an international regime to mitigate risk was emphasized. A leading ship financier, who shared the views of 11 major banks from his jurisdiction, agreed with the need for certainty and highlighted the substantial value of the assets at issue. From the perspective of lenders, it was felt that shipping markets are volatile. In light of these uncertainties, it was said that banks attempt to circumvent the problems by searching for amicable solutions, creating additional costs. Without a reliable international basis for recognition of judicial sales of vessels, it was stated that buyers would need to be satisfied with risks when obtaining the title, which would drive down the sale price.

(c) Ship registries

The registrar of the Maltese Flag, which has been the largest flag in Europe for a number of years with over 72 million tons, described the uncertainties that arise from

[7] Several references to the draft instrument were made by participants at the Colloquium. As noted in para. 3 of A/CN.9/923, "the topic has been discussed and a draft international instrument prepared at numerous meetings including the Beijing Conference in 2012, the Dublin meeting of 2013 and the Hamburg Conference of 2014 where a draft instrument was completed, and approved."

a foreign judicial sale. It was noted that most registries are national systems designed to sell domestic ships in local courts, and the difficulty of having a ship deleted from a register if it had been sold in a foreign jurisdiction was explained. It was stated that circumstances would be greatly improved for all parties by the issuance of an internationally-recognized certificate of judicial sale by the State in which a sale takes place.

It was widely felt that the creation of an instrument that retained a narrow focus on the process leading to recognition (instead of a broad project covering rules on the actual judicial sale) would be a manageable project that would increase the likelihood of having an international instrument adopted efficiently.

(d) Legal community

Legal practitioners from common law, civil law, and mixed systems cited to numerous cases, particularly cases of abuse of the process of ship arrest, in jurisdictions around the globe to highlight the lacuna in international legislation in regard to the recognition of a judicial sale by foreign court. There was a clear consensus that the number of proceedings created unnecessary costs and frictions, thereby further devaluing assets in the commercial world. From their practical experience representing clients from all aspects of the industry, participants shared the same request of filling the legal gap and enabling a friction-free transition from the former registry to the new registry, and to the new shipowner, freeing the sold vessel from all encumbrances she may have had prior to the judicial sale.

Reference was made to the work undertaken by CMI. It was felt that CMI work not only consisted of valuable in-depth studies of the problems and their possible solutions but also demonstrated interest in adopting rules that would be suitable for industries and compliant with different legal traditions.

(e) Bunker suppliers/service providers

Typical ship creditors were represented at the Colloquium by bunker suppliers, who are often also bunker barge owners. The creditors highlighted the "need for certainty which in today's economic climate overshadows any other commercial consideration." It was noted that the main concern of such creditors is the fact that they operate with very small margins and that any step undertaken outside of unified and clear patterns involve economically unjustifiable costs and risks. Support was expressed in favour of a recognition regime at the Colloquium, as a regime would introduce clear and harmonized rules and outweigh the interest in arresting the vessel after a judicial sale in an attempt to obtain funds.

(f) Crew interests

It was widely felt that seafarers on board vessels belonging to owners who had defaulted would benefit from a simplified recognition process. It was stated that the crew languish in various ports all over the world, unable to leave the vessel, and have very little by way of provisioning and fuel to keep generators going. It was felt that the longer the proceedings took, the greater the pain for the crew members, who would struggle to be paid and repatriated. The ITF Malta branch, which handles dozens of such cases, expressed its support for an instrument to mitigate the hardships endured by the seafarers and their families during such affairs.

(g) Ports/port service providers

The Malta Harbour Master explained how important it was for judicial sale procedures to be as smooth and as quick as possible to assist in the management of the phenomenon of abandoned vessels, which causes havoc in ports and undermines smooth trading operations.

(h) Maltese Government

Minister Ian Borg, Minister for Transport, Infrastructure and Capital Projects, explained that as a direct result of being the largest flag in Europe, and being in the centre of the Mediterranean, Malta heavily focused on the provision of services to the international trading community.

It was noted that Malta has a highly developed, robust and efficient legal regime providing for both judicial sale by auctions and a renowned system of court approved private sales. It was stated that all the industries, the financiers and ship builders who had mortgages registered in the Maltese Register of ships, as well as the hundreds of service providers, including ship repairers, bunker suppliers, suppliers of provisioning to ships, crew, cargo handling, trans-shipment, and services given to the oil and gas industry, needed the comfort of knowing that that they could resort to judicial sales in Malta, in the event the owner defaulted, and that those sales would be recognized worldwide. This would provide certainty to interested buyers, thereby increasing the value of the vessel during the sale.

Minister Borg thanked CMI for their initiative in bringing together a cross section of the maritime industry with the aim of discussing the pertinent subject. He stated, "Having an international instrument on the recognition of judicial sales of ships is an important step which aims to introduce a substantial degree of stability and uniformity in an important aspect of maritime trade. Malta's participation in the discussion of this important instrument is imperative."

4. Possible solutions and feasibility

The Colloquium established that the main issues and obstacles witnessed in the trade and maritime environment were:

- The lack of legal certainty in relation to the clean title which a judicial sale is intended to confer on a buyer, leading to problems being experienced in the de-registration process in the country of the former flag;
- The obstacles in relation to the recognition of the effects of the judicial sale in respect of the clearance of all former encumbrances and liens;
- The increase of transactional costs in cases of friction in the enforcement of the ship's sale and the risk of costly proceedings and payments just for nuisance value by old creditors attempting to arrest vessels after the judicial sale;
- Factoring of those risks when evaluating the level of bidding in judicial sales, causing a loss on the recoverable assets to the detriment of all creditors (such as crew, financiers, cargoes, ports, agents, bunker suppliers, barge operators, etc.) of the old shipowner resulting from a less favourable judicial sale due to the lack of certainty in respect of its recognition by courts and authorities; and
- Reduced sales proceeds leading to a downwards trend on the brokers' vessel evaluation and thereby causing a general loss of vessel values in the entire market.

Among the delegates and panellists there was consensus that:

- All parties were affected negatively by the gap in legal certainty;
- The gap could be filled from a legal perspective by providing an instrument on recognition on judicial sale of ships;
- A draft instrument that had been prepared by CMI would provide a helpful reference if work were to be taken up on this topic by UNCITRAL;
- UNCITRAL was the appropriate forum to resolve issues involving pernicious effects on cross-border trade. It was noted that UNCITRAL has experience in closely linked issues such as transborder insolvency issues and securities. The working methods of UNCITRAL, which permit close involvement of

international industry organizations, would also facilitate the conclusion of an instrument that would be broadly supported across industries.

5. Conclusion

Broad consensus emerged from the Colloquium in support of an international instrument to remedy the problems arising from the lack of harmony among States in recognizing the judicial sale of a ship in another jurisdiction. For that reason, Malta and Switzerland propose that UNCITRAL undertake work to develop an international instrument on foreign judicial sale of ships and their recognition. It is noted that CMI has undertaken significant work on identifying issues and possible solutions on this topic, and that this work has been endorsed by a number of industries and States. That work provides a useful starting point to further UNCITRAL work, providing guidance for a working group and indicating the direction that might be taken.